REPORT ON NIGERIA COUNTRY DIALOGUE

May 6-10, 2004

Initiative for Policy Dialogue

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INTRODUCTION:

In sync with boom and bust in the oil price, the Nigerian economy endured a roller coaster ride during the past two decades. During this period, real per capita income declined from $314 in 1980 to $248 in 2002, while the number of people in poverty increased[1]. Also, the manufacturing sector shrank and the share of government expenditure doubled. By any standard, Nigeria suffers from the 'resource curse'.

Against this backdrop of economic conundrum, the Initiative for Policy Dialogue (IPD) engaged in a dialogue with Nigerian policy-makers, civil society representatives and other stakeholders in January 2002. Subsequent to the first IPD dialogue in Nigeria, the Nigerian Government constituted a new economic team, with Dr. Charles Soludo[2] as the Chief Economic Adviser to the President. The new economic team prepared the 'National Economic Empowerment and Development Strategy' (NEEDS) – a strategy paper aimed to steer and implement economic development in Nigeria.

To follow-up on the initial dialogues, IPD participated in a series of discussions in Lagos and Abuja during May 6-10, 2004 (Annex I). The objective of the current dialogue was to review the economic developments since 2002, evaluate the challenges that Nigeria confronts today, serve as a catalyst for open debates, and develop critical understanding of the issues. Representatives from a number of civil society organizations, both from national and sub-national level, government officials from the National Planning Commission and the Ministry of Finance, Members of the National Assembly, business leaders from Lagos and Abuja and academics from Lagos University and Pan African University participated in the dialogues. The first public forum in Lagos (May 7, 2004) had an attendance of about 300 people while the participation in the second forum in Abuja (May 10, 2004) exceeded 400 people. The dialogues received extensive media coverage (Annex V).

The current dialogue, in broad terms, managed to generate healthy debate on important national issues among different stakeholders of the Nigerian society. In more concrete terms, the IPD team argued that the country needed a competitive (weak) exchange rate to promote its private sector. It also illustrated the need for lowering the interest rate further to increase private sector borrowing. The team also emphasized on the need to increase lending to small and medium sized enterprises and suggested a number of strategies in this regard. The team reiterated the importance of agricultural sector and rural development to help rescue the country from the 'resource curse'. Special emphasis was given to the empowerment of small farmers and community driven development strategies.

Finally, the IPD team emphasized the importance of saving part of the oil revenue and using the surplus to improve infrastructure and human capital in Nigeria. It strongly supported the impending 'Fiscal Responsibility Act' and the creation of a 'Stabilization Fund.' The team felt that these measures would improve governance, reduce fiscal deficit and increase the effectiveness of public sector spending.

IPD looks forward to following-up on the outcomes of the dialogue.

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[1] The World Development Indicators, 2003

[2] Dr. Charles Soludo – Governor-designate (as on May 11, 2004), Central Bank of Nigeria and former Executive Director of the African Institute of Applied Economics - was IPD's focal point during the first dialogue in 2002

OVERVIEW:

Many Nigerian participants in the dialogues were skeptical of government. The academics were unevenly divided between neo-liberal and Keynesians. The latter group generally opposed privatization, tariff reduction and structural adjustments, while the former demanded more reform, reduced role of government and lower corporate tax rates. Both sides, however, seemed to agree on one issue: a strong exchange rate. The Business community listed high interest rates and non-availability of credit, and poor infrastructure as the fundamental problems affecting the economy.

The bureaucracy largely opposed the arguments for downsizing the government. They agreed that corruption was endemic in Nigerian society but did not necessarily associate themselves with it. Views of politicians generally converged with that of the civil service. Civil society representatives identified corruption and governance as the number one problem in Nigeria. The foreign donors (IMF, the World Bank, EU and DFID representatives) expressed cautious optimism about the economy, lauded the efforts of the new economic team and the NEEDS document that the team has put forward. At the time, they acknowledged that reform would be very difficult to implement given the stakes and preponderance of corruption. The donors underscored the importance of enacting the 'Fiscal Responsibility Act' - to eliminate deficit spending by the federal and local governments. They also emphasized the need for creating a 'Stabilization Fund' to smooth consumption during the fall in oil price.

The IPD team (Annex II), in the course of four days, participated in two large public forums and held five separate meetings with academics, business leaders, government officials, legislators and members of the donor community. (Appendix III). The issue of exchange rate and the 'resource curse' phenomenon dominated the discussions. Among other issues, governance, corruption, and the rule of law came up repeatedly in the discussions. The participants often asked, "what is the right size of the government or what is the right reform strategy". There were also discussions on the private sector in Nigeria – its size and contribution. They also asked, "can there be very good micro-level performances under bad macro-policies?" There was also extensive discussion on how to increase aggregate demand and improve human capital.

The IPD team acknowledged that skepticism, as was evident in the discussions, was healthy, especially in a democratic and pluralistic society. However, it also urged the discussants to recognize that the government played an important role in development and that they should strive to translate the skepticism to constructive criticism and solutions.

The report is organized as following:

A. Macroeconomic Policy
    i. Exchange Rate, Inflation and the 'Dutch Disease'
    ii. Interest rate and Private Sector Development
B. Rural and agricultural development
C. Public sector reform
    i. Fiscal Discipline
    ii. Governance and Corruption
D. National Debt and management of resources
E. Human Capital
    i. Population Growth and Unemployment
    ii. AIDS/HIV issues
F. Survey on perceptions of economic problems in Nigeria Appendices

A. Macroeconomic policy: The IPD team contended that bad macroeconomic policies led to bad macro outcomes. The consequence of an ineffective macro policy is more severe in developing countries. Also, the team argued that it was very difficult to achieve good micro or household level performance under a bad macro policy. Nigeria needs a pro-poor development strategy that emphasizes job creation. The team warned that 'trickle-down' economics did not work and that the primary objective of a sound macro policy should be sustainable growth and fair of wealth. The policy should also aim to reduce uncertainty and smooth consumption. Exchange and interest rates, trade, competition or industrial policies are the macroeconomic policy tools that can effectively promote growth, create jobs and help redistribute wealth. As discussed in more detail below, the team argued that a correctly valued exchange rate would help create a competitive private sector in Nigeria. It also stressed that a low interest rate and the availability of credit were essential for private sector development. The team pointed out that the objective of trade liberalization was to shift production from low productivity to high productivity sectors. But if done incorrectly, it could lead from low productivity to zero productivity, increase unemployment and deteriorate income distribution. The team argued that policy makers in Nigeria should evaluate each argument on its own and focus on the country's dynamic comparative advantages. In this regard, the team praised the homegrown new development plan – the 'National Economic Empowerment and Development Strategy' (NEEDS).

The IPD team contended that, on average, resource rich countries around the world registered poor economic performance. The phenomenon dubbed as the 'resource curse' emanates from pervasive rent seeking behavior, high volatility of the resource price and crowding out of the non-resource dependent sectors (agriculture or manufacturing) of the economy. The Nigerian economy, endowed with oil, is inextricably linked to the volatility of oil price. Oil crowds out the non-oil sectors – the syndrome is referred to as the 'Dutch Disease'. The crowding out effect is often transmitted through an appreciated exchange rate – a strong currency that affects the competitiveness of other sectors of the economy.

B. Rural and agricultural development: The team emphasized that the agricultural sector and rural development were imperative to increase aggregate demand. The key strategy is to allow farmers to make money and save, so that they can re-invest in farm inputs and increase agricultural productivity. For this, it is important to ensure that farmers can procure their inputs from the cheapest possible source. Also, it is crucial to guarantee that farmers gain access to markets and get the right price for their output. Citing the examples of China, India and Costa Rica, the team noted that it was possible to grow the agricultural sector very fast, leading to higher national income and savings. The team argued that an over-valued exchange rate hurts the farmers disproportionately as they could not compete in the export market and are forced with cheap imports. IPD also emphasized the importance of empowering small farmers through Community Driven Development (CDD) programs. The team noted that small rural communities were more efficient at implementing projects and that corruption was much more difficult at grass root level.

C. Public sector reform: The IPD team underscored the importance of an efficient and effective public sector. It also noted that reform of the public sector did not just mean downsizing of the government. It emphasized the need for instilling more accountability and transparency in the Nigerian public sector. The IPD team cited the initiatives for 'Fiscal Responsibility Act' and the 'Stabilization Fund'.

D. National Debt and Management of Resources: The IPD team suggested that Nigeria could lower its national debt with proper management of its oil revenue. It also argued that Nigeria should qualify for debt relief. The team noted that countries that achieved a national consensus on how to use their natural resources performed significantly better than those that did not. Botswana and Azerbaijan were cited as two success stories. Nigeria was the only oil exporting country that ran a fiscal deficit even when the oil price was high. The team underscored the importance of saving part of the oil revenue for productive investment and for smoothing consumption.

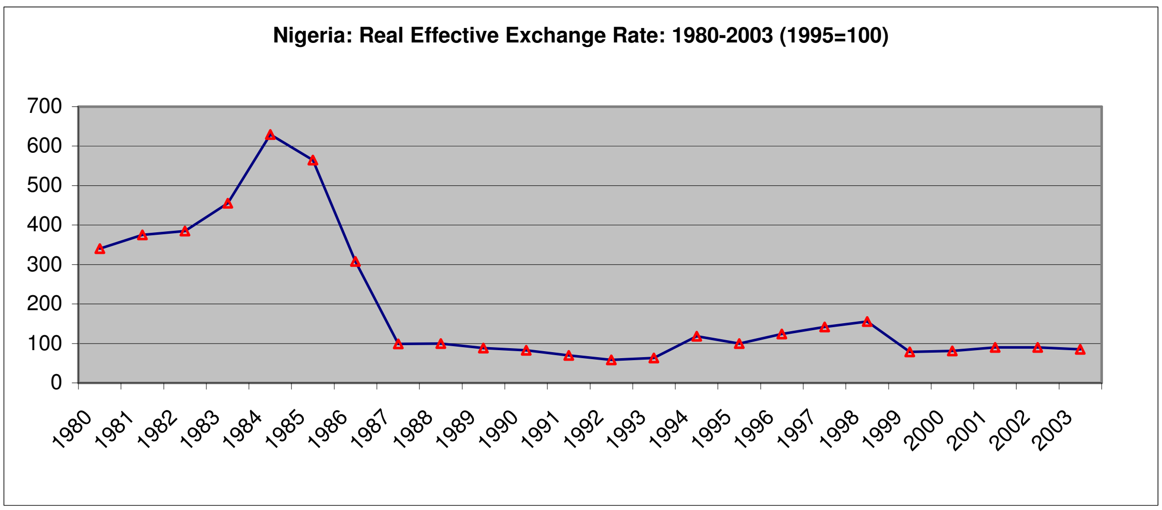
E. Human Capital: The IPD team discussed the utmost importance of improving human capital to ensure sustainable development. It argued that the government should spend more on education, health care, HIV AIDS prevention to improve the quality of human capital. The team also pointed out that a large number of educated Nigerians left the country in the last two decades and the policy makers should take measures to attract the Nigerian diaspora to help build their national economy.

F. Survey on perceptions of economic problems in Nigeria: The IPD team conducted a spot survey to assess the perception of the dialogue participants regarding a number of economic issues. A questionnaire (Appendix VI) was handed out to the participants of the public forums in Lagos and Abuja. They were requested to fill out the questionnaire before the discussion began. The team received a total of 201 responses. The result of the survey is presented in Section F.

A. MACROECONOMIC POLICY:

i. EXCHANGE RATE, INFLATION AND THE 'DUTCH DISEASE':

Background: Naira – the Nigerian currency – depreciated from 0.54/$ in 1980 to 136.40/$ in 2003 (250 fold devaluation). During the same time, inflation (annual % change in CPI) averaged 23.7% and the real exchange rate appreciated four-fold (graph below)[3].



Note: A drop in the index means appreciation of the currency

Some Perspectives:

Most Nigerians, academics and policy-makers alike, consider the exchange rate in isolation from inflation or interest rates. For them, a strong currency is almost a matter of national pride.

The Nigerian discussants, in different forums, made the following remarks:

- Devaluation of the currency eroded their purchasing power. The most often cited example was the price of a Mercedes Benz – it was told that in 1980, they could buy a Mercedes with 15,000 Naira and now this amount didn't even fetch a set of wheels.

- Nigerians have little to export, hence devaluation of the currency is unlikely to improve the trade balance or increase national welfare.

[3] International Financial Statistics, IMF, 2003

- There is no correlation between devaluation and exports and that while the currency devalued, Nigerian exports either remained stagnant or declined.

- Nigeria is a net importer of consumption goods, including food. About 95% of Nigerian export is dependent on imported contents (*claim unfounded* – import content is about 40%). Devaluation not only affects consumption but also hurts the manufacturing sector. As such, there should be a different exchange rate for the productive sector.

- The foreign exchange market is distorted – demand for foreign exchange is not a function of importation of goods, but rather a function of corruption.

- The exchange rate is artificially and administratively determined and the banks manipulate the exchange rate through round-tripping[4] and other methods. The 'Dutch auction' process in the Nigerian foreign exchange market is far from being competitive.

- Inflation is a major problem and inflation alone is the main cause of capital flight out of Nigeria. A devaluation of the currency, thus, is often counterproductive.

Other Perspectives:

- Nigerian policy makers are confronted with the challenge of balancing two, almost incompatible, policy demands – the lowest possible interest rates and the strongest possible Naira.

- A strong Naira will continue to kill the Nigerian economy.

- The Nigerian government must devise a way to restrict full monetization of the oil revenue to keep the currency from further appreciation.

- Inflation is still very high – the Central Bank estimate for 2003 is 14 %. The inflation target for 2004 is 9%. Inflation is linked to deficit spending by the government and there is no sterilization policy, in place, to ease pressure on the exchange rate.

Further Perspectives:

The IPD team felt that the discussants mis-identified the cause and effect of an over-valued exchange rate –. Nigeria had little to export because it consistently maintained an over-valued exchange rate and that it was not the lack of export that influenced the exchange rate. The team explained the 'Dutch Disease' and 'Resource Curse' phenomenon in the context of Nigeria and other 'resource-rich' countries. It illustrated how excessive dependence on oil led to destruction of the non-oil sector, transmitted via an over-valued exchange rate. The team compared Nigeria and Indonesia – both countries' dependence on oil in the early 70s were similar, both were at the same stages of development. However, the two countries differed in their exchange rate policies. While Indonesia consistently maintained a weak currency that supported the growth of both agricultural and manufacturing sectors, Nigeria did not. By the mid-nineties[5], Indonesia had a diversified export portfolio and became much less dependent on oil - its per capita income, by 1997, became four-fold higher than that of Nigeria. Unfortunately, Nigeria is still solely dependent on the oil sector. Of course, Indonesia also did a host of other things, such as provision of credit, investment in infrastructure etc,

[4] A practice whereby banks buy foreign currency at official rates only to divert to the black market for a profit margin
[5] Before the financial crisis in 1997

right. The team also gave the example of China, which maintained an under-valued currency to promote its export sector. The IPD team also made the following comments:

- The exchange rate issue should be considered in conjunction with inflation and that policy makers should look into the real, instead of the nominal, exchange rate. When inflation is taken into account, the real exchange rate of Nigeria has actually appreciated over time. Devaluation of the nominal exchange rate was inevitable because of the high inflation that the country experienced during the last two decades.

- Policymakers often make wrong inferences when both inflation and income go down – inflation hurts, so does unemployment or a loss of income. Inflation has asymmetric effects on bondholders and wage earners – the real value of long-term bonds goes down with inflation. Unfortunately, central banks and policy makers tend to worry more about the well being of bondholders, often at the expense of wage earners' welfare.

- So long as inflation remains moderate, it does not have any adverse effect on growth. In Nigeria, full monetization of the oil revenue has largely contributed to the inflation. It could follow the example of Azerbaijan and some other countries that refrained from full monetization of oil receipts to prevent inflation and keep their currency weak.

- The current exchange rate is over-valued – Nigeria needed to devalue its currency to discourage imports and to allow the agricultural and manufacturing sectors to grow. Few economies in the world grew with an overvalued exchange rate. A strong exchange rate also has re-distributive consequences, adversely affecting the wealth of the non-oil sectors.

- The right exchange rate is a necessary but not sufficient condition for growth. Governance, corruption, infrastructure and other issues also affect the competitiveness of other sectors of the economy.

- Productivity-improvement of the non-oil sector could neutralize the adverse effects of an over-valued currency. However, Nigeria did not register productivity growth in the non-oil sectors.

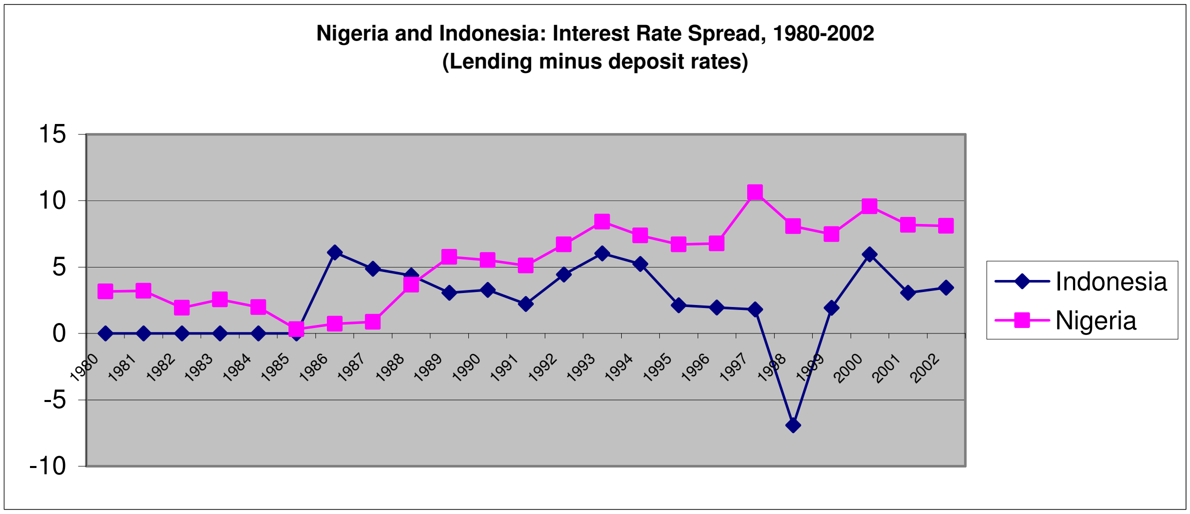
- Creation of a stabilization fund, reduction of deficit and non-monetization of oil revenue will ease the inflationary pressure. This will lead to weakening of the currency and facilitate growth of the non-oil sector.

ii. INTEREST RATE AND THE PRIVATE SECTOR DEVELOPMENT:

Background: Lending rates in Nigeria averaged 17.8% over the past twenty years[6]. The Central Bank of Nigeria, in 2003, reduced the Minimum Re-Discount Rate (MRR) – the rate at which Banks can borrow from the Central Bank - to 15% and allowed banks to add a 4% mark-up on MRR. But, the current average lending rate of 20.7% is still very high. There are about 80 commercial banks in Nigeria but banks' assets (total claims or lending to public and private sector) to GDP ratio is .17 – one of the lowest in the world. Bank finance is significantly limited if not non-existent altogether.

Nigeria has an underdeveloped private manufacturing sector. The share of the manufacturing sector is about 4% of the GDP and has steadily declined from 8.5% in 1980. The government is trying to stimulate the manufacturing sector with selective bans on import of certain products. Since 2000, 40 products have been added to the list of banned items, including the ban on import of fruit juice and textile.

[6] International Financial Statistics, IMF, 2003



Some Perspectives:

All stakeholders – private sector, civil society, academics and government officials – acknowledged that the interest rate was very high. They recognized the 'crowding out' effect of the public sector borrowing and the role of fiscal deficit in hiking the interest rates. They also acknowledged that level of interest rate was critical in influencing the growth of the private sector. They were also aware that lowering the interest rate could generate inflation.

A number of discussants contended that the Nigerian economy suffered from an oligopolistic market structure in most sectors. Both access to, and exit from, the market is difficult. They also argued that privatization programs and deregulations did not improve the competitiveness of the private sector. Another discussant argued that price signals did not work in a distorted economy.

A number of academics favored the import ban. They argued that the ban was likely to promote domestic manufacturing sector. Others argued that while the country significantly lowered its tariff, which led to surge in imports, the advanced industrial countries did not open up their markets to the Nigerian exports. In the same vein, others argued that Nigerian manufacturing sector was not competitive and that it could not withstand foreign competition. Another argument was that the commercialization/privatization policy did not achieve any of the macroeconomic objectives and deregulation negatively affected employment. However, the discussants did not acknowledge the role of an over-valued exchange rate in deterioration of Nigerian exports.

Other Perspectives:

- The donors (IMF and the World Bank representatives) reiterated that the Nigerian policy makers were saddled between two inherently incompatible objectives – low interest rates and a strong Naira.

- The donor community viewed the bans primarily as import substitution and contended that it was unlikely to enhance the efficiency of the manufacturing sector or increase employment. They informed the IPD team that import bans were imposed on popular demand by the President and without the concurrence of the Finance Minister or the Central Bank. The bans are also unpredictable, they added.

Further Perspectives:

The IPD team concurred with the discussants that the interest rate was indeed very high and it was detrimental to private sector development. The team suggested that some central banks followed strict monetary policy in fear of inflation, but such policies often stifled growth and increased unemployment. A lower interest rate, even if it leads to moderate inflation, is a better policy option to stimulate growth.

The IPD pointed out that although most of those engaged in the debate considered the interest rate to be too high, they seemed to attach limited importance to the issue. The discussion also did not take into account the linkage between interest rates, exchange rates and inflation. The IPD team made the following additional remarks:

- Policy makers should not just look at the lending rate. What is important is the 'spread' – the difference between the lending and borrowing rates. The spread is significantly high in Nigeria compared to that in other countries.

- Both the terms and availability of credit is important for growth of the private sector.

- The small and medium size enterprises (SME) are the engine of economic growth and that the SMEs depend on bank finance to support their expansion. Loans given by the Small Business Administration (SBA) played a significant role in small business development in the U.S – the success of FedEx was cited as an example. Nigeria needs to improve lending to SMEs.

- The government, especially the Central Bank, can adopt a number of measures to lower the interest rate. One measure could be to give government deposits to banks that offer lower rates to the SMEs and lend to the real sector of the economy.

- The example of the 'Community Reinvestment Act' (CRA), which provides for targeted lending (to underdeveloped communities) in the U.S., was cited, and it was suggested that Nigeria could adopt similar measures to promote lending to small and medium sized enterprises.

- Fiscal discipline is crucial for reducing interest rate. The 'Fiscal Responsibility Act' and the ability to save during the oil boom will reduce the crowding out effect. Reduced borrowing by the government will allow banks to increase lending and reduce interest rates.

- The import ban could work if it was designed to support an infant industry. IPD cited the examples of Korea where industrial policies, with specific 'sunset clauses', were in place to support the growth of certain industries. An import ban, aimed at import substitution, will not increase national welfare.

- A sound competition policy is a *sine qua non* for private sector development. Nigeria could improve the competition laws to facilitate market access and prevent price distortion.

- Availability of infrastructure is also very important to facilitate private sector development. It was pointed out that the Lagos port was one of the slowest ports in the world – average clearing time was 33 days compared to the world average of 2 days. The structural bottlenecks – lack of roads, electricity, water supply etc – impede the growth of the private sector.

B. RURAL AND AGRICULTURAL DEVELOPMENT:

Background: Agriculture value-added to GDP is about 37%. Land usage is very low, stagnant at around 30%. Food import, as percentage of total merchandise imports, increased from 6% in 1990 to about 20% in 2000.[7]

Some Perspectives:

In the discussions, especially in the meetings with the policy-makers and government officials, agriculture did not feature prominently. While a group of academics supported the ban on import of certain manufactured goods, there was little discussion on the means to improve the efficiency of the agricultural sector. A few argued that the inputs for agricultural production were mostly imported and that a weak Naira actually hurt the agricultural sector. One discussant, however, emphasized the importance of agriculture given that 70% of the population *(incorrect claim* - share of employment in agriculture is only 2.9%[8]) was employed in the sector. The academics and policy-makers also recognized the under developed production technology in agriculture and the absence of productivity growth. The discussants also commented:

- A number of state governments have taken initiatives to improve the lot of small farmers. In Ebonyi State, the government has invited small-scale Chinese rice farmers while the federal government is trying to attract large-scale Zimbabwean farmers.

- Majority of farmers in Nigeria are women, who traditionally are not even entitled to land ownership. As such, there is a connection between support for agriculture and gender issues. Many of the women farmers need encouragement and property rights that the government should ensure to improve agricultural productivity.

- Nigeria should conserve valuable foreign exchange for things that cannot be produced domestically. Nigeria has no reason to import rice and some other staple foods when they can be produced locally.

Other Perspectives:

Donors recognized that agriculture was a neglected sector in Nigeria and there was little support from the government to improve agricultural productivity. They informed that poor land rights, factionalism and tribal disputes adversely affected agricultural development.

Further Perspectives:

The IPD team commented:

- The growth of the agricultural sector will increase the earnings of the farmers. This will lead to more domestic savings and investment and will, consequently, reduce the reliance on oil.

- A competitive exchange rate and sound macroeconomic policy will help increase farm profits. Increase in the profits of the farmers will be an incentive for further development of the sector. However, a number of other macroeconomic issues and infrastructure facilities – market access, roads and irrigation facilities – have to be put in place. It is important that farmers are guaranteed unhindered access to the market, both domestic and international, and that they receive fair price for their outputs.

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[7] World Development Indicators database. Please see Annex IV.
[8] World Development Indicators database

- Agricultural productivity gains will come from efficient use of input and from technological improvements. Research and extension services for the farmers are crucial to improve farm productivity. The role of the U.S. government in providing agricultural extension services was cited as an example.

- India, China and many other developing countries did not invite foreign farmers to develop their agricultural sectors. Nigeria did not need to invite Zimbabwean farmers to improve its agricultural productivity. The government could give similar incentives (free land, access to road, irrigation facility, electricity etc) to local farmers and obtain far better productivity growth. Large commercial agriculture is important but productivity growth will come from empowering small farmers. Experience around the world shows that larger farms are less efficient than the small-scale farmers.

- Community Driven Development (CDD) strategies are very effective for rural development. In CDD programs, funds for projects go directly to the local government and communities. Local communities and farmers know their interests best and they know which irrigation projects or roads will increase their production or improve market access – they are powerful instruments for development. Mexico registered resounding success in community driven development programs with over 700,000 projects funded in ten years. Implementation of CDD strategies require political will at the highest level and responsive local governments. Nigeria needs to adopt such community driven development strategy.

- The growth of the agricultural sector will eventually lead to growth of other sectors of the economy, increase national savings and improve standards of living.

D. PUBLIC SECTOR REFORM:

i. FISCAL DISCIPLINE:

Background: The public sector is quite large in Nigeria. Government spending accounts for 27% of the GDP – it more than doubled since 1990[9]. By some estimates, 70% of the oil revenue is used up to maintain the 1.2 million strong federal bureaucracy and the parastatals. By constitutional provision, the federal government is required to share the oil revenue with state and local governments. There are 36 state and 736 local governments in Nigeria – each of them receives a monthly check from the federation account.

The federal finance ministry is responsible for preparing the budget. The draft budget is then presented to the National Assembly for approval. The members of the National Assembly often increase the budget by 25-30% to accommodate their individual wish lists. The members can make changes in line item allocations. The budget approval process is quite contentious and time-consuming. As of the month of May, the budget for 2004 was still being negotiated.

The finance ministry is striving to achieve a balanced budget, using the benchmark oil price of $25/barrel. It is also trying to pass the 'Fiscal Responsibility Act' to reduce deficit and create a 'stabilization fund' to save excess oil revenue at the federal level.

Some Perspectives:

The discussants recognized that the government was too big and that they needed to save when the oil price was high. However, there was no agreement as to how they could achieve the fiscal balance. The public sector representatives generally opposed the downsizing of the government on the ground that

[9] World Development Indicators database. Please see Annex IV.

job cuts in the government, unless accompanied by job growth in the private sector, would only increase unemployment and reduce national welfare. They all agreed that corruption was costing the economy significantly but then disagreed regarding the source of corruption. It was often suggested that corruption was often more pervasive at the state and local levels *(state and local government representatives were not present in the dialogues)*. They argued that lack of transparency and monitoring at state and local levels led to waste of resources. The discussants remarked:

- There should be more transparency and accountability in public expenditure.
- Public expenditure at the lower tiers of government is inefficient – they often lack the capacity to spend the allocations effectively.
- Federal resources should go to the lower tiers of the government only as matching grants. At the same time, there is need to build capacity at that the local level and this includes the capacity for data collection and monitoring.
- State and local level borrowing should be restricted.

Other Perspectives:

- Fiscal federalism is not functioning – there is nearly no accounting for 50% of the government spending that takes place at state and local levels.
- Cost of running government is exorbitantly high (about 70% of the oil revenue) – there are not enough funds to finance infrastructure development.
- The 2004 budget is a major departure from expansionary fiscal policy. It has put controls on spending and has provided for a surplus. However, the National Assembly is likely to change the proposed budget for 2004 and the surplus will disappear in the supplementary budget.
- Oil price is unlikely to stay as high. The government is not adequately prepared to tackle the next bust. The 'Fiscal Responsibility Act' has not been passed yet and is likely to face stiff resistance from the lawmakers.
- Fiscal Responsibility Act, if passed, will restrict domestic borrowing.

Further Perspectives:

IPD team generally concurred with the views expressed by the Nigerian discussants. They made the following additional comments:

- Problem of fiscal federalism is not unique to Nigeria – many other federal structures face similar problems of sharing resources and responsibility among different levels of the governments.
- Fiscal discipline does not simply mean downsizing the government. The government could increase the efficiency in public sector expenditure and reduce transaction and overhead costs. The U.S. Social Security Administration, a government entity, is as efficient as the private sector in rendering the service.
- The federal government can indirectly influence the state and local governments to adhere to higher accounting and transparency standards. The Central Bank can make it difficult (i.e. not

giving government deposits) for commercial banks to lend to states that do not maintain proper accounting system.

ii. GOVERNANCE AND CORRUPTION:

Background: Nigeria ranks very high on the corruption indicators compiled by the Transparency International[10]. Its governance and rule of law indicators are also very poor, discouraging foreign investment and stagnating economic growth.

Some Perspectives:

There was unanimity in the pervasiveness of corruption in the Nigerian society. Again, there is disagreement regarding the sources of corruption – each stakeholder apparently blamed the others for inefficiency and corruption. The Ministry of Finance has taken a number of initiatives to curb corruption and increase transparency. One of the talked about measure is the disclosure of payments to state and local governments. The initiative reportedly met with stiff opposition from different sources. The discussants (mostly academics and civil society representatives):

- Acknowledged the need for transparency. But part of the challenge of foisting transparency is to have a proper definition of the role of government. Must first define what government should do, and what it should not.
- The Extractive Industries' Transparency Initiative (EITI) – to which Nigeria is a signatory – is a step in the right direction to track down the uses of oil revenue and curb corruption.
- The political leadership admitted that government has serious credibility problem. Members of the senate agreed to cooperate with the President's economic team, give them every support and enact legislations to facilitate their work.
- The National Assembly will soon consider a bill that will broaden the coverage of the 'due process laws' to other areas of procurement, and enhance the power of ICPC to fight corruption.
- There is a need to scrutinize the huge spending for elected officials so that, in the name of reforms, poor workers are not retrenched to pave the way for more embezzlement of public funds.

Other Perspectives:

- Corruption is endemic in Nigeria – all levels of governments are infested with corruption.
- The economic team is trying hard to promote accountability, transparency and due process in awarding of contracts.
- Public sector reform is very difficult. If unemployment remains very high, the argument to downsize the government will remain unpersuasive. Besides, the unions are very strong.
- Nigeria has more gas than oil. By 2012, its earnings from LNG will exceed that from oil. But that will not lead to employment growth[11]. The government now has a window of opportunity

[10] Nigeria ranked as the number 2 most corrupt country in the world in TI's Corruption Perception Index for 2001, 2002 and 2003

to make fundamental reforms – it will be more difficult to reform when the oil and gas revenue will double.

- Privatization of the power sector and other state-owned enterprises is unlikely to happen in the near future, mainly due to opposition from the unions.

- Domestic resource mobilization and tax reform still have a long way to go.

Further Perspectives:

The IPD team shared the views of the discussants. It agreed that job growth in the private sector was important to effectively implement public sector reform. It also emphasized that public sector reform did not just mean downsizing the government – it also meant increasing the efficiency of public spending. The team acknowledged that improving transparency in awarding of contracts and more scrutiny of public expenditure would increase the efficiency of the government and increase national saving. They also commented:

- There is an emerging 'third way' – a government not too large, yet not too small - to determine the appropriate role of the government. The stakeholders need to reconsider what regulations are needed and what are not.

- In many countries, civil societies are organized only at the national level – they should scale-down to community levels to push for 'bottom-up' reforms and improve governance and transparency in lower tiers of government.

- The 'citizens' right to know' is fundamental in instituting transparency and accountability in a society. Following the example of the U.S. (Freedom of Information Act) and many other countries, Nigeria could adopt an effective 'right to know' legislation to fight corruption at all levels of the government. This issue was extensively discussed during the previous IPD dialogue in 2002 and two Presidential hopefuls have pledged to make this the main theme for their campaign. The next presidential election is in 2006.

- The Central Bank can force the financial system to be transparent by putting public resources in banks that have sound accounting standards.

D. NATIONAL DEBT, SAVINGS AND INVESTMENT:

Background: Even by Latin American standards, Nigeria's foreign debt is not exorbitant – in 2002, external debt amounted to about 75% of Gross National Income (GNI) and 175% of export revenue. The debt service accounts for about 9% of export earnings. Nigeria accumulated these foreign debts during the 1980s.[12]

Some Perspectives:

The discussant expressed the view that Nigeria was burdened with excessive debt. A substantial part of Nigeria's GDP goes into servicing debt *(not true* – only about 2% of GDP). They felt that foreign debt did not help the Nigerian economy and that actually the money never stayed in the country. They blamed corruption and inefficiency of the public sector spending for the accumulation of foreign debt.

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[11] Oil sector is highly capital intensive – growth in this sector does not translate into job growth
[12] World Development Indicators database. Please see Annex IV.

A few suggested that Nigeria should henceforth refuse to take new foreign loans. Also important is that this debt is seen as odious debt acquired during the dictatorship. The discussants:

- Supported the benchmark oil price of $25/barrel, instead of $23/barrel, to prevent borrowing and eliminate the deficit. At $23/barrel government would have run a deficit in fiscal 2004.

- Questioned the fungibility of foreign funds and whether Nigeria could now borrow at low interest rates to retire its high interest debts.

- Suggested that Nigeria should not save the excess oil revenue, at least not in foreign banks. It should rather use the windfall to build infrastructure, railways and invest in human development.

Other Perspectives:

- Nigeria is now eligible for IDA loans on concession terms.
- Nigeria's foreign debt and debt service are at manageable levels and hence the country is unlikely to qualify for debt relief

Further Perspectives:

The IPD team viewed that Nigeria should be considered for debt relief but warned that debt relief alone would not solve all of Nigeria's problems. The team suggested:

- Nigeria should take advantage of the favorable oil price to retire some of its high interest bearing loans.

- Since funds are fungible, Nigeria could also take new low interest IDA loans to implement government projects and then use the funds that it saves on those projects to reduce the debt burden.

Nigeria needs to effectively and prudently manage its debt portfolio to safeguard national interests

- Nigeria must save for the rainy days, in anticipation of a bust – This is not saving for future generations but rather short-term savings to smooth consumption and investment.

- Further borrowing, if at all needed, should be for investments only. Such investments must have potential for high returns; and these should be based on domestically determined needs, not based on projects dictated from outside or by the international development agencies.

- It does not make sense to save and build up financial assets and international reserves in foreign banks when the same resources can be used to build real assets in the local economy and help create jobs.

E. HUMAN CAPITAL:

i. POPULATION GROWTH AND UNEMPLOYMENT:

Background: Population grew at an annual average of 2.85% during the last 20 years. At 133 million, Nigeria is the most populous country in Africa. Nigeria is ranked 152, out of 175 countries, in UNDP's Human Development Index. Life expectancy at birth is only 45.3 years and has steadily declined since the mid 1980s.[13]

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[13] World Development Indicators database. Please see Annex IV.

Some Perspectives:

The discussants underscored the problem of population explosion in Nigeria. They remarked:

- Just because Nigeria produces oil does not make it rich a rich country. Over the years, there has been tremendous increase in population but little increase in resources.

- Nigeria has inadequate human capital - suggested that lack of skill was more problematic than lack of capital.

- Budget allocation for health and education is one of the lowest in the world.

- Only a growing private sector can absorb the excess supply of human capital. The NEEDS document recognizes that private sector jobs has to be created before public sector jobs are destroyed. The challenge is to achieve this within the shortest possible time. However, government can help the process by reducing its fiscal deficits.

Other Perspectives:

- Lack of skill is a major problem - professional level is very thin. There has been very little investment in human resource development.

- Payroll and pension liabilities are increasing and dependency ratio is also on the rise.

Further Perspectives:

The team commented:

- Rapid population growth is not, in itself, very bad provided the economy grows at a healthy rate and there is effective management of resources. China was cited as an example.

- It is also important that the country attracts its huge human resources living abroad and reverses the 'brain drain'. Nigerian immigrants are among the most educated immigrant groups in the U.S. – there are 23,000 Nigerian-born medical doctors in the U.S. The government should adopt a strategy to tap these resources overseas to bolster both investment and human capital stock.

ii. HIV/AIDS ISSUES:

Background: The official HIV AIDS prevalence rate is about 5% - rather low, at least, by African standard. However, it is contended that unofficial actual prevalence rate is much higher.

Some Perspectives:

The discussants seemed least concerned about the AIDS epidemic. No discussant raised the AIDS as a major problem.

Other Perspectives:

- Immunization rate dropped significantly in the recent years – one of the lowest in the world.

- Fundamentalist Muslim leadership in the North is spreading the words that immunization will spread HIV infection – this is partly the manifestation of mistrust about the government and government-sponsored programs.

- HIV prevalence rate reportedly dropped from 5.5% in 2001 to about 5% in 2004 – the decline is, however, unrealistic. More and more AIDS victims refrain from reporting in fear of social stigma.

- In one semi-random survey, 70% of the 150 men, recruited for the army, were found HIV positive.

Further Perspectives:

The team attached great importance to the HIV/AIDS problem in Nigeria. They commented:

- AIDS has the potential to explode in Nigeria. They need to reach a national consensus and mobilize all resources to combat the epidemic.

- The global Fund, through the World Bank, has allocated about $200 million to combat AIDS epidemic in the country.

- Currently, no more than 300,000 of the 3.5 million or so AIDS victims in Nigeria are being treated. There is no reason why the other 3 million or more should be left to die.

- With subsidy from a number of agencies, retroviral drugs are being provided for poor people in the developing countries at a low rate of $400 a year. This is obviously far cheaper than a single life. It is also more cost effective to save these people, as majority of them are young and productive.

- It is also important to know that the public sector alone cannot effectively implement country's HIV/AIDS program. The private sector and the NGOs will also have to come forward to fight the scourge of AIDS.